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CITATIONS

77359—38

In the Supreme Court of the United States

OCTOBER TERM, 1938

No. —

THE UNITED STATES, PETITIONER

v.

FREDERICK PLEASANTS

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Claims entered in the above-entitled cause.

OPINION BELOW

The opinion of the Court of Claims was entered April 4, 1938, and is reported in 22 F. Supp. 964.

JURISDICTION

The judgment of the Court of Claims was entered April 4, 1938. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Court of Claims erred in holding that, in computing a taxpayer's net income under Section 23 (n) of the Revenue Act of 1932 as the base of which 15 per cent is allowable for charitable deductions, a capital net loss should be disregarded.

STATUTE INVOLVED

The applicable portions of the Revenue Act of 1932 will be found in the Appendix, *infra*, pp. 11–14.

STATEMENT

The special findings of fact of the Court of Claims may be summarized as follows:

Respondent duly filed his individual income tax return for the year 1932 on March 15, 1933, showing a total tax of $161.77, which was paid on the same date. On this return respondent reported a total income of $99,123.31, consisting of salaries, interest, and dividends, and total deductions of $5,235.15, consisting of taxes paid, losses by fire, storm, etc., and contributions to charitable organizations. He also reported a capital net loss of $157,642.62. (Fdg. 1.)

As a result of an audit of respondent's books and records the Commissioner of Internal Revenue determined that there was an additional tax due from the respondent in the amount of $908.92, and so notified respondent on April 13, 1934. The deficiency in tax of $908.92, together with interest

of $60.87, aggregating $969.79, was thereafter assessed and, upon demand, the same was paid on May 12, 1934. (Fdgs. 3, 4.)

In arriving at the deficiency in tax the following adjustments were made: (1) Gross income was reduced to $96,702.67 from $99,123.31. (2) The total deductions claimed on the return were reduced to $1,739.15 from $5,235.15. This reduction was caused by the disallowance of the charitable deductions on the ground that since the ordinary net income reduced by the capital net loss resulted in a net loss for the year, there was no income against which to apply the 15 percent deduction for charitable contributions under Section 23 (n) of the Revenue Act of 1932. (3) Capital net loss was reduced to $154,921.98 from $157,642.62. (Fdg. 3.)

On May 19, 1934, respondent duly filed a claim for refund for $969.79 for 1932 upon the ground that the amount of $3,496 representing charitable contributions, being less than 15 percent of his taxable net income, was a proper and legal deduction. This claim was rejected on January 17, 1935. (Fdg. 5.) This suit was filed in the Court of Claims March 6, 1936.

On April 4, 1938, the Court of Claims rendered an opinion in favor of respondent and entered judgment in the amount of $969.79, together with interest from May 12, 1934.

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that capital net losses are not deductible from gross income in arriving at the "net income" under Section 23 (n), Revenue Act of 1932.

2. In holding that the "net income" to be used as the base for the computation of the 15 percent deduction for charitable contributions is to be computed without taking into account a capital net loss sustained by the taxpayer, where the tax as computed under the provisions of Section 101, Revenue Act of 1932, is larger than the tax computed without regard to the provisions of that section.

3. In failing to hold that since the respondent's capital net loss exceeded his ordinary net income as computed without any adjustment for such capital net loss, there was no "net income" within the meaning of Section 23 (n), Revenue Act of 1932.

4. In failing to enter judgment for the United States and dismiss the petition.

REASONS FOR GRANTING THE WRIT

The Court of Claims has held in the present case that in computing the taxpayer's "net income" specified in Section 23 (n) as the measure of which 15 per cent may be allowed for charitable deductions, a capital net loss may not be taken into account. Respondent had an "ordinary" net income, i. e., income exclusive of capital gains and

capital losses, in the amount of $94,963.52. He had a capital net loss of $154,921.98. The Commissioner of Internal Revenue determined that respondent had no "net income" within the meaning of Section 23 (n), and hence was entitled to no deduction for charitable contributions. The Court of Claims held, however, that he was entitled to such a deduction in an amount not in excess of 15 per cent of $94,963.52.

1. The decision of the Court of Claims is in direct conflict with the decisions of two Circuit Courts of Appeals. *Avery* v. *Commissioner,* 84 F. (2d) 905 (C. C. A. 7th), certiorari denied, 299 U. S. 604, rehearing denied, 300 U. S. 686; *Lockhart* v. *Commissioner,* 89 F. (2d) 143 (C. C. A. 3d), certiorari denied, 302 U. S. 711; *Heinz* v. *Commissioner,* 94 F. (2d) 832 (C. C. A. 3d). It is in conflict also with the decisions of the Board of Tax Appeals. *Nippert* v. *Commissioner,* 32 B. T. A. 892; *Hill* v. *Commissioner,* 33 B. T. A. 891, affirmed on another ground, 88 F. (2d) 941 (C. C. A. 8th); *Zimmerman* v. *Commissioner,* 36 B. T. A. 618, pending on appeal in the Circuit Court of Appeals for the Third Circuit. It is at variance with the opinion in *Bliss* v. *Commissioner,* 68 F. (2d) 890, 892 (C. C. A. 2d), affirmed, 293 U. S. 144. The Court of Claims stated in its opinion herein that it is "unable to concur in the decisions" of the Third and Seventh Circuit Courts of Appeals and the Board of Tax Appeals. Following the decision of this Court in *Helvering* v. *Bliss,* 293 U. S.

144, the decisions of the Board and the lower courts have been uniformly opposed to the holding of the court below.

2. The decision is in substantial conflict with the decision of this Court in *Helvering* v. *Bliss*, just cited. That case presented the question whether in computing the "net income" to be used as a base for the measurement of allowable charitable deductions under Section 23 (n), a capital net gain was to be included as part of the net income. It was argued that Section 101 (a), which provides a method for segregating capital net gain and taxing it at a special rate, required the exclusion of capital net gain from the computation of net income under Section 23 (n). This Court rejected that argument, holding that nothing in Section 101 (a) affected the definition of net income in Section 23 (n), that the definition of "net income" clearly contemplated the inclusion of income of every sort, including capital gains, with a deduction for capital losses, and that the special method and rate of tax provided by Section 101 did not affect the content of net income within the meaning of Section 23 (n).

The present case involves a capital net loss, instead of a capital net gain, and the special method and rate of tax thereon are prescribed in Section 101 (b) instead of Section 101 (a), but the reasoning and conclusion of the *Bliss* case are equally applicable here. Section 23 (n) provides that the 15 per cent limitation on charitable deductions

shall be measured by "net income." That term is defined (Sec. 21) to mean "gross income computed under section 22, less the deductions allowed by section 23." Gross income under Section 22 clearly includes capital gains, and the deductions allowed by Section 23, specifically losses incurred in trade or business or in any transaction entered into for profit, clearly include capital losses.[1] Hence the fact that capital net losses (that is, capital losses minus capital gains and capital deductions) are segregated by Section 101 (b) for the purpose of computing a separate tax does not justify their being ignored in determining the base upon which to compute the 15 per cent limitation for charitable contributions, any more than the segregation of capital net gains for computing a separate tax justified ignoring them for computation of the 15 per cent limitation in the *Bliss* case.

The decision below substitutes for "net income" as used in Section 23 (n) "ordinary net income," used in Section 101 and defined (Sec. 101 (c) (7)) as "net income, computed in accordance with the provisions of this title, after excluding all items of

[1] If there were any doubt that Section 23 referred to capital losses, it would be removed by Section 101 (c) (4) of the Act, which provides that for the capital net loss determination the term "ordinary deductions" means "the deductions allowed by section 23 other than capital losses and capital deductions." There would be no necessity for the addition of the words "other than capital losses and capital deductions" if those items were not included in Section 23.

capital gain, capital loss, and capital deductions." It was precisely this view which was rejected by the Court in the *Bliss* case, where it was said (293 U. S. at 146–147):

> For "net income," the base specified in § 23 (n) upon which the 15 per cent. deduction of charitable contributions is to be calculated, the petitioner would substitute "ordinary net income" as defined in § 101. So to read the Act would violate its plain terms and run counter to the history of the legislation.

Indeed, the opinion in the *Bliss* case appears to assume that the decision therein is controlling in cases of capital net loss. The Court cited with evident approval (p. 151, note 8) the ruling in I. T. 2104, III–2 Cumulative Bulletin 152, which held that capital net losses should not be excluded in computing the net income upon which the 15 per cent limitation for contributions is measured. In addition, this Court apparently accepted the decision of the Board in a capital net gain case, *Straus* v. *Commissioner* 27 B. T. A. 1116, as a reversal of the Board's prior position not only with respect to capital net gains (*Harbison* v. *Commissioner*, 26 B. T. A. 896; *Bliss* v. *Commissioner*, 27 B. T. A. 896; *Colgate* v. *Commissioner*, 27 B. T. A. 506), but also with respect to capital net losses (*Elkins* v. *Commissioner*, 24 B. T. A. 572; *Livingood* v. *Commissioner*, 25 B. T. A. 585). See 293 U. S. at 146, note 2.

It is true that the Government's position in the present case, involving a reduction in the base for measuring the limit of charitable contributions, works to the disadvantage of the taxpayer, while the holding in the *Bliss* case worked to the taxpayer's advantage. This result was expressly adverted to by the Court of Appeals in the *Bliss* case, and was deemed to fortify its conclusion, since it enabled the court to put aside in that case any rule of interpretation requiring exemptions to be narrowly construed (68 F. (2d) at 892). In other applications as well, it has been recognized that the introduction of the capital net gains provisions was meant to be favorable to the taxpayer, and the capital net loss provisions favorable to the Government. See *Piper* v. *Willcuts*, 64 F. (2d) 813, 815–816 (C. C. A. 8th).

3. The question involved is one of importance in the administration of the Federal income tax laws. The same or similar provisions with respect to capital losses appear in the Revenue Acts of 1924, 1926, 1928, and 1932. Beginning with the Revenue Act of 1934 a radical change was made in the method of treating capital gains and losses, so that this question will not arise under the later Acts; there are, however, at least eighteen cases now pending in the Board of Tax Appeals, involving approximately $500,000, which present the same question as that herein, two appeals pending in the Third and Eighth Circuit Courts of Ap-

peals, and, we are informed by the Chief Counsel, Bureau of Internal Revenue, a considerable number of similar cases pending before the Income Tax Unit of the Bureau. The question is, therefore, one of present importance calling for review by this Court.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Court of Claims should be granted.

ROBERT H. JACKSON,
Solicitor General.

JUNE 1938.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax equal to the sum of the following:

* * * * *

SEC. 12. SURTAX ON INDIVIDUALS.

(a) *Rates of surtax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows:

* * * * *

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the

time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

* * * * * *

(n) *Charitable and other contributions.*—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * * to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary * * *.

* * * * * *

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) *Tax in case of capital net gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) *Tax in case of capital net loss.*—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the

basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) *Definitions.*—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * *

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